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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS**

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In re :
 : **Case No. 04-81694-SAF-11**
VARTEC TELECOM, INC., et. al. : **(Jointly Administered)**
 :
 : **Hearing Requested: December 2, 2004**
 : **at 2:30 p.m. (Central Time)**
Debtors. :
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**EMERGENCY MOTION FOR ADEQUATE ASSURANCE OF
PAYMENT WITH RESPECT TO
POSTPETITION UTILITY SERVICES,
OR ALTERNATIVELY, FOR ADEQUATE PROTECTION**

TO THE HONORABLE STEVEN A. FELSENTHAL,
UNITED STATES BANKRUPTCY JUDGE:

MCI WORLDCOM Network Services, Inc., (formerly, MCI Telecommunications Corporation) (“MWNS”) and MCI WORLDCOM Communications, Inc. (“MWCI,” and together with MWNS, “MCI”), file this Emergency Motion for Adequate Assurance of Payment With

Respect to Postpetition Utility Services, Or Alternatively, For Adequate Protection (the “Motion”), and respectfully represent as follows:

GENERAL BACKGROUND

1. On November 1, 2004 (the “Petition Date”), VarTec Telecom, Inc. and all or substantially all of its direct and indirect subsidiaries (collectively, the “Debtors”) commenced cases under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). The Debtors continue to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. Pursuant to its authority under section 1102 of the Bankruptcy Code, on November 8, 2004, the United States Trustee for the Northern District of Texas (the “U.S. Trustee”) appointed a statutory committee of unsecured creditors in the Debtor’s chapter 11 case (the “Committee”).

JURISDICTION

2. This Court has jurisdiction to consider and determine this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding pursuant to § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

BACKGROUND

The Debtors’ Relationship to MCI

3. MCI and its affiliates comprise one of the world’s preeminent global telecommunications companies, providing a broad range of communication services to its customers, including long distance voice and data communications, domestic interstate and international outbound and inbound services, and private line services. MCI has provided the Debtors with these and other telecommunications services pursuant to various contracts, agreements and/or tariffs (the “Agreements”) with a current monthly run rate of approximately \$2.5 million.

4. As of the Petition Date, the Debtors owed MCI approximately \$20 million¹ for telecommunications services, plus additional amounts owed under a certain guaranty agreement between the Debtors and MWNS. The enormity of MCI's prepetition claim against these chapter 11 estates is due in large part to the Debtors' long history of not paying their bills from MCI when due. In fact, MCI had placed a credit-hold on the Debtors just prior to the filing of these chapter 11 cases.

5. MCI invoices the Debtors for these telecommunications services on a monthly basis, and in most circumstances the Debtors have thirty (30) days to satisfy their outstanding obligations under the agreements. Consequently, MCI's credit risk with respect to the Debtors' postpetition operations will likely approach \$5 million within the first two months of these chapter 11 cases.

The Lack of Adequate Assurance

6. In this case, MCI faces a substantial risk of non-payment for its postpetition telecommunications services. Even though the Debtors have already stated in their pleadings that they have **no** unencumbered cash on hand to pay MCI, the Debtors have (1) asked this Court to prime MCI's administrative expense claims in favor of their secured lender, (2) sought to waive their right to surcharge the lender for the benefits conveyed by MCI's postpetition services, and (3) failed to provide MCI with any assurance of payment in their Motion for Order Approving Debtors' Provision of Adequate Assurance of Payment to Utilities [Docket # 15] (the "Utility Motion"). The Debtors' current cash flow forecast also indicates that

¹ This figure represents MCI's preliminary estimate of its prepetition claim for the various telecommunications services it has rendered to the Debtors.

they will have a negative cash position for the next two months.² Moreover, in recognition of the risk of non-payment of administrative expenses, the Debtors' primary counsel, Vinson & Elkins, has requested payment during the administration of these cases on a bi-weekly basis despite the fact that (a) the post-petition financing obtained by the Debtors provides for a carve-out for professional fees in the amount of \$1.5 million plus budgeted fees in the event of written notice of default sent by RTFC and (b) counsel currently holds a retainer.

7. On November 1, 2004, the Debtors' filed their Motion for Interim and Final Orders (i) Authorizing the Debtors to Use Cash Collateral, (ii) Authorizing the Debtors to Incur Post-Petition Financing on an Interim and Final Basis with Superpriority Over Administrative Expenses and Secured by Senior Priming Liens, (iii) Scheduling a Final Hearing and Establishing Notice Requirements, and (iv) Granted Related Relief [Docket # 34] (the "DIP Loan Motion"). In the DIP Loan Motion, the Debtors state that "independent working capital resources and financing are not available in a sufficient amount to enable the Debtors to carry on their operations." See the DIP Loan Motion at ¶ 19. In response to this dire financial condition, the Debtors propose a postpetition financing regime in which the Rural Telephone Finance Cooperative (the "RTFC") will have priority over all administrative creditors of these estates and the Debtors will waive all rights under section 506(c) of the Bankruptcy Code to surcharge the RTFC for the cost of telecommunications services used to sustain the Debtors' postpetition operations. See the DIP Loan Motion at ¶ 21(c) and Exhibit A thereto.

8. Given the extraordinary relief sought in the DIP Loan Motion, the RTFC apparently considers its financial risk in this case substantial. Notwithstanding, the Debtors and the

² See Exhibit A to the Court's Second Interim Order, dated November 4, 2004, Authorizing Post-Petition Financing, Granting Senior Liens and Priority Administrative Expense Status, Authorizing Use of Cash Collateral and Modifying the Automatic Stay.

RTFC apparently want to transfer that risk entirely to MCI and the other utilities that provide millions of dollars in telecommunications services to these Debtors.

9. While the Debtors and the RTFC apparently believe that MCI (and other telecommunications utilities) should finance the Debtors' effort to restructure its admittedly underperforming operations, section 366 of the Bankruptcy Code prohibits this result. In this case, the Debtors' Utility Motion fails to provide any assurance of payment to MCI, much less adequate assurance, even though the Debtors admit that telephone services are utility services for purposes of section 366 of the Bankruptcy Code. *See* the Utility Motion at ¶ 19.

10. Due to the Debtors' failure to provide adequate assurance of payment, MCI reserves the right to refuse or discontinue telecommunications service to the Debtors in accordance with section 366(b) of the Bankruptcy Code. Should the Debtor wish to continue to receive MCI's telecommunications services, MCI submits this Motion in order to set forth the amount of security necessary to provide it with adequate assurance of payment.

RELIEF REQUESTED

11. MCI hereby respectfully requests that this Court enter an order pursuant to section 366 of the Bankruptcy Code that: (a) requires a cash deposit in an amount equal to the Debtors' average monthly billing from MCI plus an amount sufficient to cover services between the end of the billing period and the due date of payment for that period, or approximately \$5 million; (b) requires immediate payment for the postpetition services used by the Debtors as of the date of such order and for which they have not yet paid MCI; and (c) authorizes MCI to immediately terminate services upon nonpayment of charges when due, without further notice or order of the Court.

12. As an alternative form of adequate assurance of payment, MCI respectfully requests that this Court enter an order that: (a) requires bi-weekly prepayments to MCI in an amount equal to one-half of the average monthly billing from MCI, or \$1.25 million; (b) requires immediate payment for the postpetition services used by the Debtors as of the date of such order and for which they have not yet paid MCI; and (c) authorizes MCI to immediately terminate services upon the Debtors' failure to make such prepayments when due, without further notice or order of the Court.

BASIS FOR RELIEF REQUESTED

13. Section 366 of the Bankruptcy Code applies to a debtor's utility service providers. In pertinent part, section 366(b) provides that a "utility may alter, refuse, or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date."

14. **MCI is a utility.** While the Bankruptcy Code does not define the term "utility," the common and ordinary usage of that term includes telecommunications service providers. That definition would be consistent with the use of the term "utility" in other statutory contexts. *See, e.g.*, 47 U.S.C. § 224(a)(1) (defining the term "utility" as, among other things, "any person who is a local exchange carrier³ . . . and who owns or controls poles, ducts, conduits, or rights-of-way used, in whole or in part, for any wire communications"); TEX. UTIL. CODE § 51.002(11) (defining the term "telecommunications utility" as, among other things, "a communications carrier who conveys, transmits, or receives communications, wholly or partly over a telephone system").

³ The term "local exchange carrier" is defined at 47 U.S.C. § 153(26).

15. Indeed, the House Report issued at the time Congress enacted section 366 explains that the section:

is intended to cover utilities that have some special position with respect to the debtor, such as an electric company, gas supplier, or telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 350 (1977); S. Rep. No. 989, 95th Cong., 2nd Sess. 60 (1978). Accordingly, the term “utility” in section 366 “has always been given a broad meaning by courts consistent with the common and ordinary meaning of the word.” *In re Abraham*, Case No. BK01-41713, 2002 BANKR. LEXIS 1788 at *7 (Bankr. D. Neb. April 11, 2002); *see also In re Good Time Charlie's Ltd.*, 25 B.R. 226, 227 (Bankr. E.D. Pa. 1982) (applying the term “utility” to a shopping center owner who was supplying electricity to the debtor). For example, even in this case the Debtors’ Utility Motion seeks to provide adequate assurance of payment to several landlords who supply the Debtors’ utility services.

16. In *One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc.* (*In re One Stop Realtour Place, Inc.*), 268 B.R. 430, 435 (Bankr. E.D. Pa. 2001), a telephone company took the position that it was not a “utility” for purposes of section 366 of the Bankruptcy Code because it was not a monopoly as indicated in the legislative history. The court rejected this argument, stating first that it had no reason to look at legislative history because the statute is unambiguous. *See id.* at 436. Second, the court noted that the term “utility” has always been given broad meaning and includes those businesses that provide telephone service to the public subject to state and federal regulation. *See id.* at 436-37. Even where the debtor is itself a telecommunications carrier purchasing telephone service from other carriers, courts have concluded that section 366 applies. *See, e.g., In re Tel-Central Communications, Inc.*, 212 B.R. 342, 343 (Bankr. W.D. Mo. 1997) (stating that court had previously ruled that, where the debtor

was engaged in the business of reselling long distance telephone minutes provided by another carrier, the carrier providing those minutes was a utility for purposes of section 366 despite its arguments to the contrary). Accordingly, MCI is a utility and section 366 of the Bankruptcy Code requires the Debtors to provide adequate assurance of payment.

17. **As adequate assurance the Debtors may provide a cash deposit.**

Determinations of adequate assurance under section 366 are fully within the Court's discretion. *In re Marion Steel Co.*, 35 B.R. 188, 195 (Bankr. N.D. Ohio 1983). Nevertheless, section 366(b) expressly states that the form of adequate assurance must be "a deposit or other form of security." Bankruptcy courts have the exclusive responsibility for determining what constitutes adequate assurance for payment of postpetition utility charges and are not bound by local or state regulations. *See In re Begley*, 41 B.R. 402, 405-406 (E.D. Pa. 1984), *aff'd*, 760 F.2d 46 (3d Cir. 1985).

18. In determining adequate assurance, the Court must determine that MCI is not subject to an **unreasonable risk** of non-payment for postpetition services. *See In re Caldor, Inc.*, 199 B.R. 1, 3 (S.D.N.Y. 1996), *aff'd sub. nom., Virginia Elec. & Power Co. v. Caldor, Inc. New York*, 117 F.3d 646 (2d Cir. 1997); *In re Santa Clara Circuits West, Inc.*, 27 B.R. 680, 685 (Bankr. D. Utah 1982); *In re George C. Frye, Co.*, 7 B.R. 856, 858 (Bankr. D. Me. 1980). Assuming that the Debtors and the RTFC successfully prime administrative priority expenses, and the Debtors waive their surcharge rights under section 506(c), an administrative claim against these Debtors provides no assurance of payment whatsoever. Given the Debtors' prepetition failure to pay expenses when due, their declining revenues, negative cash position, and the fact that all cash on hand is cash collateral of the RTFC, the Court should require the Debtors to tender a cash deposit lest MCI face the unreasonable risk of being forced to finance

the Debtors' reorganization involuntarily. Section 366 of the Bankruptcy Code expressly prohibits this result. Consequently, MCI respectfully submits that under these facts, the Court has more than an ample predicate to require a cash deposit as adequate assurance of payment under the terms of section 366 of the Bankruptcy Code.

19. Moreover, the amount of the cash deposit should equal the average amount of unsecured credit extended by MCI during one full billing cycle, or 60 days. *See In re Stagecoach Enterprises, Inc.*, 1 B.R. 732, 734 (Bankr. M.D. Fla. 1979). In *Stagecoach Enterprises*, the court required a deposit in this amount based on the facts presented, including the amount of time in a billing cycle and the debtor's nonpayment history. These Debtors use MCI's telecommunications services as a core component of their ongoing business operations. Clairvoyance is not required in order to anticipate the Debtors might be forced to liquidate their assets for less than the amount of the RTFC's secured interest in those assets. As noted above, the Debtors already forecast that they will have a negative cash position no later than November 14, 2004 and for the next two months. The Debtors and the RTFC should not be allowed to transfer the risk of the Debtors' postpetition administrative insolvency to MCI.

20. **Alternatively, the Debtors should make bi-weekly prepayments.** In the event that the Debtors do not have sufficient cash on hand to tender a cash deposit in the amount of a complete billing cycle, MCI submits that the Court should require the Debtors to make prepayments on the first and fifteenth day of each month to MCI in an amount equal to one-half of the average monthly billing (\$1.25 million) as adequate assurance of payment.

21. Moreover, in the event that the Court determines that MCI is not entitled to adequate assurance of payment, MCI asks for the same relief pursuant to section 363 of the Bankruptcy Code.⁴ Section 363(e) of the Bankruptcy Code provides that:

[n]otwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

11 U.S.C. § 363(e). Pursuant to section 363(e), MCI is an entity with an interest in property used or proposed to be used by the debtor in possession. MCI and its affiliates own and maintain one of the largest domestic telecommunications networks, including circuits, facilities, and equipment. The Court is empowered to condition the Debtor's use of the property such that MCI's interest will be adequately protected. Should the Court determine that section 366 does not apply under these circumstances, MCI submits that the Court should require the Debtors to make the same prepayments on the first and fifteenth day of each month to MCI in an amount equal to one-half of the average monthly billing as adequate protection.

22. MCI hereby reserves the right to seek such other and further relief as is just under the circumstances.

Relief Should Be Granted on an Expedited Basis

23. MCI has an immediate risk of non-payment for postpetition use of its telecommunications network. The Debtor appears to have no available cash on hand even

⁴

MCI is aware of the vacated Memorandum Opinion in *In re Comm South Companies, Inc.*, Case No. 03-39496. Nevertheless, MCI submits that most court's have held that section 366 of the Bankruptcy Code protects telephone companies, such as MCI, that provide telephone services to a reseller. *See, e.g., In re Sun-Tel Communications, Inc.*, 39 B.R. 10, 10 (Bankr. S.D. Fla. 1984). While the *Comm South* opinion has been vacated by the Bankruptcy Court and thus has no precedential value, MCI submits that it would be entitled to the same relief under section 363 of the Bankruptcy Code.

though its current usage of the MCI network averages approximately \$2.5 million per month. Accordingly, MCI requests entry of the order attached hereto on an expedited basis.

WHEREFORE, MCI respectfully requests entry of an order granting the relief requested herein and such other and further relief as is just.

Dated: November 17, 2004
Dallas, Texas

Respectfully submitted,

/s/ James T. Grogan III

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CERTIFICATE OF SERVICE

I hereby certify that on November 17, 2004, a copy of the foregoing Motion was served by email, facsimile and/or United States first class mail, postage prepaid to all the individuals/entities identified on the service list annexed hereto as Exhibit A and was also so served on counsel for the Debtors, counsel for the Official Committee of Unsecured Creditors, counsel for the Rural Telephone Finance Cooperative, and the United States Trustee.

/s/ James T. Grogan III
James T. Grogan III

EXHIBIT A
SERVICE LIST

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829352.1

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**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS**

-----X
In re :
 :
VARTEC TELECOM, INC., et. al. : **Case No. 04-81694-SAF-11**
 : **(Jointly Administered)**
 :
 Debtors. :
-----X

**ORDER GRANTING EMERGENCY MOTION FOR
ADEQUATE ASSURANCE OF PAYMENT WITH RESPECT
TO POSTPETITION UTILITY SERVICES,
OR ALTERNATIVELY, FOR ADEQUATE PROTECTION**

Upon consideration of the motion of MCI WORLDCOM Network Services, Inc., (formerly, MCI Telecommunications Corporation) (“MWNS”) and MCI WORLDCOM Communications, Inc. (“MWCI,” and together with MWNS, “MCI”), for Adequate Assurance of Payment With Respect to Postpetition Utility Services, Or Alternatively, For Adequate Protection (the “Motion”), and pursuant to which MCI seeks an order pursuant to section 366 of the Bankruptcy Code that provides, *inter alia*, for adequate assurance of payment from the Debtors with respect to postpetition services rendered by MCI to the Debtors various Agreements¹, as more fully explained in the Motion; and it appearing that the Court has jurisdiction over this matter; and it further appearing that due and proper notice of the motion has been given; and it further appearing that MCI is a qualifying entity under section 366 of the Bankruptcy Code; it is hereby ORDERED THAT

1. The Motion is granted;

¹ Capitalized terms that are not otherwise defined herein shall have the meaning ascribed to those terms in the Motion.

2. Pursuant to section 366 of the Bankruptcy Code, the Debtors shall provide MCI with adequate assurance of payment of all postpetition charges by means of the following: (a) the Debtors shall immediately tender to MCI a cash deposit in the amount of \$5 million; (b) the Debtors shall make immediate payment for the postpetition services used as of the date of this order and for which they have not yet paid MCI; and (c) MCI is hereby authorized to immediately terminate all services rendered to the Debtors upon nonpayment of any charges when due, without further notice or order of the Court.

3. Except as otherwise set forth herein, this Order shall be effective immediately.

Dated this ____ day of _____, 2004

UNITED STATES BANKRUPTCY JUDGE